MUNICIPAL PERSONAL INCOME TAXATION OF NONRESIDENTS

It is a commonplace that America's largest cities face fiscal crises of varying intensities. The reasons are not hard to find. In a period of rapid inflation provision of even traditional city services would require raising larger amounts of money each year. Our standard of living has risen rapidly in the past decade and, J. K. Galbraith to the contrary notwithstanding, Americans expect some improvement in public services to accompany improving private consumption. But higher quality public services cost more money. The sixties saw the emergence of a much better organized municipal employees' labor movement than we had heretofore experienced; the initial representation battles won, these groups invariably fought for higher salaries and wages—and the strike has proven a particularly useful instrument in their hands. Finally, we came in the sixties to makes some sort of public commitment to sharing our national product more equitably, to helping our impoverished citizens to break out of the cycle of dependency. Insofar as this commitment implies a services strategy as opposed to pure income transfers,[1] it involves spending more money on those services which have traditionally been furnished largely by cities or by cities and states in cooperation. To all of these demands for increased current expenditures must be added the fact that the social capital of many cities is antiquated and needs replacing—Boston has not built a new school building for over thirty years.

Few economists and fewer local public officials believe the cities can raise the needed funds themselves. They begin by trying to estimate gross amounts of local expenditures. In 1965 the Council of State Governments projected that state-local general expenditures would reach $108 billion by 1970.[2] Such estimates are necessarily based on speculative assumptions for example, that welfare costs would rise less rapidly from 1962 to 1970 than they had from 1957 to 1962.[3] Because such estimates are speculative, they have tended in the past to underestimate expenditure increases. And indeed the Advisory Commission on Intergovernmental Relations (hereinafter, "ACIR") reported that spending had reached $93.771 billion by 1966-67.[4] George Break, in his book *Intergovernmental Fiscal Relations in the United States*, cites several projections of state-local tax revenue elasticity with GNP increases. These various assumptions yield 1970 tax

[1] J. Wilson, *Urban Problems in Perspective*, in THE METROPOLITAN ENIGMA 351 (Wilson ed. 1968).

[2] G. BREAK. INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES 15 (1965).

[3] *Id.* at 13.

[4] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS (ACIR), STATE AND LOCAL FINANCES: SIGNIFICANT FEATURES 1966-69 25, Table 9 (1968).

revenues for states and localities of between $64 and $70 billion, leaving a gross revenue gap of $30 to $56 billion.[5] Even if user-charge revenue and federal grants-in-aid continued to grow at their 1952-62 rates, they would fill the revenue gap only if it were in the $30 billion end of the range projected.[6] And events since 1965 suggest that Break may have underestimated the revenue gap, especially in its local portion.

Various structural proposals for bailing out the cities have been made. Many economists have long favored greater use of the personal income tax by states, with consequent revenue increases available for city aid; in several states suggestions have been made that the state assume particular functions—*e.g.*, Massachusetts now pays for welfare statewide and Governor Milliken has proposed that Michigan take over educational financing from its localities. Proposals to share the revenue from the federal income tax with states and localities, first suggested by Melvin Laird, have attracted a great deal of support from economists and now from the Administration. Finally, proposals to reorganize metropolitan areas, so that some functions may be performed and financed on an areawide basis, continue to attract attention; Mayor White has proposed a limited form of such metropolitanization for the Boston area.

From the point of view of political officials and concerned citizens in the central cities, all of these proposals have a major defect: they leave the determination of the city's fiscal fate largely in the hands of outsiders—federal or state legislators or suburban politicians. State and federal aid programs must run the yearly gamut of the appropriations process; despite the fervor of some of the litigants, it seems unlikely that reapportionment is going to improve the political position of the very large cities to the point where they can control that process in their states. Most federal revenue sharing proposals have suggested that the funds be channeled through a trust fund so that they would not have to be appropriated every year. This would make them somewhat less politically vulnerable, but the allocation could still be changed by a determined Ways and Means Committee. Metropolitanization requires in most states the initial concurrence of suburban voters and, depending upon how integrated the resulting structure was, would probably require continual bargaining with either suburban electorates or their elected representatives. Thus even if one or several of these reform proposals were adopted, the central cities would obtain more funds only at the cost of some of their autonomy.

Some may object that the value of municipal autonomy is not readily apparent. At the very least, it cannot be conclusively demonstrated. To a great extent, it rests upon the arguments advanced for state autonomy and diversity by Mr. Justice Brandeis in *New State Ice Co. v. Liebmann*.[7]

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5 BREAK, *supra* note 2, at 20.

6 *Id.* at 20-21.

7 285 U.S. 262 (1931).

By providing arenas in which different sorts of social priorities may be adopted, municipal autonomy may provide the experience upon which to base national policy priorities. Additionally, there is much to be said for the proposition that local officials are in the best position to judge the quality and quantity of local public needs. Finally, the sought autonomy is only relative; the state and federal governments retain legal sovereignty and the superior fiscal power which will enable them significantly to influence local behavior through incentive grants-in-aid.

In their quest for more revenue from their own sources, America's large cities have increasingly turned to the municipal income tax. The purpose of this paper is to examine the interpenetration of economic and legal theory as they apply to this tax, especially that portion levied on the income of commuters and other nonresidents. Attention will first be focused on the demography and economics of metropolitian areas. Then the economic theory of taxation of the metropolis will be examined. A short description of the actual use of the municipal income tax follows. Then the major portion of the paper will deal with the law governing the use of the tax, especially the theory of taxation which emerges from the case law.

I. *The Economic Basis of Municipal Taxation*

As of October, 1967, roughly 64 per cent of the American population lived in the so-called Standard Metropolitan Statistical Areas (SMSA's),[8] and the figure was expected to reach 68 per cent by 1975.[9] The Bureau of the Census definition of the SMSA requires that it contain at least one city with a population not less than 50,000. In addition, it will generally include the surrounding county (towns and cities in New England) and adjacent counties which are metropolitan in character (contain a certain percentage of non-agricultural workers) and are "economically and socially integrated with the county containing the central city."[10] This definition permits very considerable differences in size among SMSA's:

Population	*Number of SMSA's*[11]
Over 3,000,000	5
1,000,000 to 3,000,000	19
500,000 to 1,000,000	29
250,000 to 500,000	48
100,000 to 250,000	89
50,000 to 100,000	22

There is also very considerable variation among the states in the percentage of their population living in SMSA's: ten states have over 75 per cent,

8 ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *Metropolitan Fiscal Disparities* 27 (Washington, 1967).

9 *Id.*

10 J. BOLLENS & H. SCHMANDT, THE METROPOLIS 7 (1967).

11 *Id.* at 18.

ten have less than 20 per cent.[12] This latter fact undoubtedly conditions greatly the political stance of cities when they seek assistance from state legislatures.

Correlated with the variations in size are variations in growth patterns and in the concentration of "urban problems" in the central city of the SMSA. In the largest SMSA's and in the older central cities of some of the smaller areas, the central city population is growing much more slowly than the area as a whole.[13] For example the central city population of the five largest SMSA's grew only 1 per cent from 1950 to 1960, while the outside central city area grew 71.3 per cent.[14] (These figures include population added by annexation of new territory. The figures are even lower when annexations are factored out.) The ACIR details the disparities in social and economic indicators between central cities and outlying areas at great length.

The increasing concentration of black people in the central cities of the SMSA's is an often noted phenomenon. Associated with this concentration is a marked increase in the proportion of the city's population under fifteen.[15] The city also has more than its share of those over sixty years of age.[16] Family income is markedly higher in the outside central city areas. The table below shows the ratio of the number of families with incomes over $10,000 per 100 families under $3,000 as of the 1960 Census:

Size of Area	*Total*	*Central City*	*Outside Central City*
3,000,000	183.0	126.7	311.5
1,000,000 to 3,000,000	160.5	97.3	238.9
500,000 to 1,000,000	95.6	73.8	129.3
250,000 to 500,000	82.8	78.6	87.4
100,000 to 250,000	70.3	73.1	66.6
Less than 100,000	67.0	76.3	44.0
Total[17]	123.9	93.5	169.4

These factors combine to give the central city a disproportionate share of the public assistance caseload. In 1966 New York City had 44 per cent of New York State's population and 70 per cent of its public assistance cases; for other cities the figures were Philadelphia, 17.8 and 32.8; Baltimore, 26.8 and 66.4; St. Louis, 15.5 and 25.5; Richmond, 4.9 and 15.2.[18] Educational attainment as measured by median number of years of school completed is less in the central city.[19] A larger proportion of central city

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[12] *Id.* at 16.

[13] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *supra* note 8 at 31.

[14] *Id.* at 32.

[15] *Id.* at 40.

[16] *Id.*

[17] *Id.* at 42, Table 9.

[18] *Id.* at 41, Table 8.

[19] *Id.* at 46.

housing is unsound and central cities have higher unemployment rates.[20] The ACIR concludes that "the Nation's central cities are becoming inhabited to an increasing extent by 'high cost' citizens."[21] While the disparities are greater within the metropolitan areas of the Northeast and Midwest, the pattern is the same throughout the country.

These disparities in social and economic indicators have led to disparities in actual expenditure by local governments. On the one hand, "in 32 out of the 36 largest SMSA's, the outside central city educational expenditures exceeded those of the central city, sometimes by more than $100 per capita."[22] The per capita gap has grown from $19 in 1957 to $42 in 1964-65.[23] ACIR concludes, "This is a perverse expenditure pattern if it be true, as we believe it to be, that children from underprivileged families require a greater educational outlay to compensate for the educational deficiencies of their home environment."[24]

On the other hand, outside central city areas spent only $132 per capita for noneducational purposes in 1964-65, 75.9 per cent less than the central cities ($232),[25] primarily because of differences in welfare expenditures. These disparities resulted in a significant differential in tax burden: central city residents pay 7 per cent of their income to local governments in taxes, while suburbanites pay only 5.4 per cent of their larger incomes.[26]

The currently existing disparities are the result of a migration process through the cities which is nearly as old as the country itself. Raymond Vernon describes this process in great detail; at all stages it has been built upon the ability of the relatively well-to-do to live at some distance from their places of employment and to exclude poorer people from their residential areas.[27] The process was made technically feasible by the trolley and later the automobile and inter-urban railroad. It was made legally feasible by zoning laws and ordinances. (Coupled, of course, with market pricing of choice residential sites.) In the earliest stages this migration was merely from the center of the city toward the outskirts, but at some point the migrants began to cross the city's legal borders in larger numbers. Cities have occasionally grown by quantum leaps by annexing either large tracts of surrounding unincorporated land or by swallowing up theretofore "suburban" communities. (For example the formation of Greater New York in the 1890's, the consolidation of Boston in 1914.)[28] But as legis-

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[20] *Id.* at 47.
[21] *Id.* at 55.
[22] *Id.* at 65.
[23] *Id.*
[24] *Id.*
[25] *Id.* at 71.
[26] *Id.* at 77-9.
[27] R. VERNON, THE MYTH AND REALITY OF OUR URBAN PROBLEMS 12, 14 *Passim* (1966).
[28] R. WOOD, SUBURBIA: ITS PEOPLE AND THEIR POLITICS 77 (1959).

latures have become freer with the municipal incorporation privilege, and as suburbanites have become conscious of rising city tax rates, annexations have become increasingly difficult. It is a significant factor in urban government today only in the West and Southwest. The result of suburban resistance has been that while the SMSA's may be "economically and socially integrated" they are never united under one municipal government.[29] Suburbanites were able to protect their independence during the fifties and early sixties when they were the most underrepresented portion of the population in state legislatures;[30] they are less likely to lose the battle now that reapportionment is occurring.

Suburbanites are well aware that city tax rates are higher and that a large proportion of city revenue goes for public assistance measures, while suburban taxes are spent on good schools. In fact, these different taxing and spending patterns, as well as the diversity in public finance *among* suburbs, has been thought an advantage by some economists because it increases the choices of public benefits open to persons deciding where to locate in a given metropolitan area.[31] Public spending decisions, and the level of taxes they imply, must be fairly visible to make this sort of mechanism work.

Political fragmentation permits fiscal fragmentation because local governments rely so heavily on the real property tax for revenue. This tax is peculiarly localized in theory and operation. The tax is said to operate *in rem*—against the property itself—so that if the owner has no income, the land can be sold to pay the taxes. The theoretical price for *in rem* operation is that the tax can only be levied by a government which has jurisdiction of the *res*, not of the owner. Cities have occasionally been given extraterritorial power to zone land near their borders, but almost never power to tax outside their boundaries. Indeed it is doubtful whether, as a matter of constitutional law, a city could be given such power. American states cannot exercise extraterritorial power *in rem* against either real or tangible personal property.[32]

The *in rem* operation of the property tax presents cities with a difficult predicament because of the metropolitan growth patterns just described. Their continuation has led commercial property to follow residential property to the suburbs. Under the impetus of World War II expansion, heavy industry moved away from the very center of the city; the incentive was lower land values and the possibility of using new material-handling tech-

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[29] BOLLENS & SCHMANDT, *supra* note 10 at 7.

[30] *See* R. DIXON, JR., DEMOCRATIC REPRESENTATION (1968).

[31] Charles M. Tiebout, *A Pure Theory of Local Expenditures*, THE JOURNAL OF POLITICAL ECONOMY, October, 1956; W. Thompson, A PREFACE TO URBAN ECONOMICS 259, 263 (1965).

[32] I. Cooley, THE LAW OF TAXATION § 92, at 218 (4th ed. 1924).

niques which required one-floor construction.[33] As soon as the war ended, retailing, wholesaling, and services followed, often crossing city boundaries in the move.[34] In the suburbs the value of this new construction cannot be reached by the central city's real property tax.[35]

In addition to the erosion of its base in the city, the property tax suffers from other serious infirmities. Primary among these is its low elasticity of revenue yield. Since the war the national wealth in land and structures has been growing 1.38 times faster than gross national product, so the principal base of the property tax, real estate, is expanding fast enough to yield increased revenue.[36] But as Break shows, the yield elasticity of the property tax is estimated by the ACIR to be between 0.7 and 1.1, much lower than the rate of growth of wealth in land. When the ACIR figures are adjusted to represent constant effective tax rates, the prospects are even dimmer. While the yield elasticity for 1957-63 was 1.8, the Council of State Governments did not expect it to be higher than 1.2 for 1963-70.[37] To keep the effective rate constant city officials must make one of two painful choices: raise the nominal rates or raise the assessments. Each of these decisions is highly visible and usually unpopular, and therefore doubly distasteful to politicians. As pointed out above city councils must raise rates or assessments just to keep up with inflation, yet each of these increases incurs the same public disapproval as increases for new programs or improved services.

Other factors inhibit the use of the property tax to finance increased local expenditures. Most states impose limitations on property tax rates so that cities could not raise rates very much even if their electorates were predisposed to do so. Furthermore, cities compete with one another for large taxpayers. Property taxes are probably not a very important consideration in the relocation decisions of most businesses but city interest groups which benefit from low rates may be counted upon to argue that taxes are everything in industrial planning. The argument apparently gains weight through repetition; the electorate is brought to believe that low rates help it compete for business.

Even if the property tax could be expanded quickly enough and widely enough, it is undesirable for localities to place so much reliance upon this particular public finance instrument.

In the first place, the residential property tax is highly regressive at lower levels of the income distribution: the poor are likely to pay a much higher proportion of their income for property tax than any other segment

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33 Vernon, *supra* note 27.

34 John F. Kain, *The Distribution and Movement of Jobs and Industry*, in Wilson, *supra* note 1.

35 ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *supra* note 8, at 82.

36 NETZER, THE ECONOMICS OF THE PROPERTY TAX 184-90 (1966).

37 BREAK, *supra* note 2, Tables 1-13 & 1-15.

of the population, although the tax becomes progressive in the highest income groups.[38] The property tax is also less visible to the poor than to the middle classes because the latter pay it directly in two or four large installments while the former pay it indirectly as a portion of their rent. This may lead to a distortion of assessment practices in which multiple dwellings are assessed at a greater percentage of their market value than single family dwellings, an obvious inequity if the residents bear the tax in both cases.[39]

Second, the property tax has a distorting effect on consumption of housing in all income classes. The tax in most places is largely a tax on housing consumption at much higher rates than apply, through the sales tax, to the consumption of other goods. This effect is only partially offset in income brackets over $10,000 by the deductibility of the property tax from adjusted gross income for federal income tax purposes. It is not offset at all for those people who use the standard deduction. And of course apartment dwellers may not deduct the tax at all because it is not imposed directly on them,[40] although they bear most of its burden indirectly.[41] It is illogical to tax housing consumption so heavily when we are trying nationally to increase the supply of low-income housing.

Third the property tax has a deterrent effect on central city urban renewal at least insofar as it involves commercial property. New buildings are an obvious target for the assessor and commercial property in general tends to be assessed at more nearly its market value than residential property.[42] But developers must pay taxes out of income and property taxes do not decrease when income falls off. Unlike the individual or manufacturer making a location decision, the developer is making an initial investment decision. If he expects property taxes to rise while rental values remain stable, he will hesitate before locking himself into an investment with a steadily declining rate of return.

Fourth, the possibility of manipulating assessment/market value ratios affords an opportunity for discrimination and political favoritism. Despite legal requirements for uniform assessment, cities may display systematic discrepancies from neighborhood to neighborhood in the ratio of assessed value to market value.[43] The applicaion of legal remedies may require expensive research beyond the capacity of most taxpayer litigants.

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38 NETZER, *supra* note 36, at 54.

39 *Id.* at 75-83.

40 INT. REV. CODE of 1954, § 164.

41 NETZER, *supra* note 36, at 36.

42 NETZER, *supra* note 36, at 79.

43 Oliver Oldman & Henry Aaron, *Assessment-Sales Ratios under the Boston Property Tax*, 18 NATIONAL TAX JOURNAL 36 (1965).

II. *The Economic Theory of Municipal Taxation*

How then ought the metropolitan area support its governmental activities? Given that political fragmentation is likely to continue, is some fiscal integration of the SMSA's justified?

Public finance theory is concerned with the effect of government upon two major economic problems—the problem of distribution, how wealth and income should be distributed among the population; and the problem of allocation of resources, how scarce resources should be allocated among different producers of goods in order to maximize social utilities. In the metropolitan context, these questions may be restated:

1. What effect, if any, should local governments try to have on the distribution of income within the SMSA?
2. What fiscal arrangements will ensure the optimal production of public goods for the metropolitan area as a whole, whether produced by the suburbs, the city, the state, or the federal government?

Dealing with the first problem requires economists to construct a general ethical justification for taxation. Taxes take wealth or income from citizens compulsorily; once governments have collected the revenue, they must make spending decisions which perforce affect the distribution of wealth, even if in unintentional directions. Taxpayers in demanding justifications for expenditure programs almost invariably advert to these distributional effects and argue the merits of programs in terms of these effects.

A general justification of taxation is obviously a matter of political philosophy. One prominent position, which may be called the benefit theory, holds that it is the receipt of benefits from a government which ethically obligates a citizen to contribute through taxes to its support. This proposition is closely related to the contractual theory of the basis of the state. Musgrave points out that the benefit justification was advanced by Hobbes, Locke, Hume, Rousseau, and Bentham, men prominent for their espousal of the notion that political obligation is based upon some sort of contract between the individual and society.[44]

At its most rudimentary level, the benefit justification says nothing about the *amount* of taxes which each person should pay; it merely erects an obligation to pay some taxes upon the notion of reciprocity: the citizen is obliged because he agreed to be obliged and because he takes advantage of the protection of his interests afforded by forming a government with his fellow countrymen.

But the benefit theorists argue on a second level by contending that the *amount* of taxes which a citizen pays should be adjusted to the *level of benefits* which he receives from the government. This is what John Stuart

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[44] R. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 63 (1959).

Mill called the *quid pro quo* theory of taxation;[45] it attempts to distribute the costs of government according to the amount of government services consumed by the taxpayer. Furthermore, it advances this theory as an ethical proposition—this is said to be the most equitable distribution of the burdens of government. The same theory is advanced as an economic proposition because it is thought that it will lead to an efficient allocation of resources by government; that justification for the benefit theory will be considered below.

The major difficulty with the benefit theory as an ethical proposition at this second level is that it assumes a proper distribution of wealth and income in society absent the tax and that the government should not be concerned with redistributing wealth or income, either directly through transfer payments or through free public distribution of the services it produces. Since under this theory the citizen must pay the cost of the government services he consumes, the government becomes just another producer in the market and every citizen consumes only what he can afford to pay for. This ethical view no longer has wide acceptability. Even those who oppose direct transfer payments by and large support the provision of some free public services like parks, police protection, and some minimum public education. If these goods are to be consumed free by the poorest citizens, they must be paid for by someone else who is not the primary beneficiary.

It is usually when it is presented at this second level of operation that the benefit theory is contrasted with the so-called "ability-to-pay" theory. As developed by Seligman, this theory is based on two branches, the privilege branch and the sacrifice branch.[46] It is said on the one hand that the state provides privileges to the citizen which facilitate his acquisition of income or wealth and that in general the amount of wealth he is able to accumulate is directly related to the number and sort of privileges he enjoys. He could, then, justifiably be taxed in proportion to these privileges, which determine his ability to pay. On the other hand, the sacrifice branch asks how the tax system may equalize the burdens that taxpayers bear. Arguing from the supposed marginal utility of income, the theory concludes that sacrificing a larger proportion of his income is less of a burden for the wealthier, higher income, taxpayer. Both branches of the theory rely, as Seligman points out,[47] upon a more organic theory of the state than the contract theory. Locke for example, regarded man as having rights, most importantly the right to acquire wealth, in society entirely apart from government, whereas the "ability-to-pay" theorists see (correctly, I think) how important government-created/protected rights are to that acquisition.

Musgrave points out that the "ability-to-pay" theory emphasizes the

[45] *Id.* at 62.

[46] E. SELIGMAN, STUDIES IN PUBLIC FINANCE 187.

[47] *Id.* at 185.

compulsory nature of taxation.[48] In fact, it more or less assumes that everyone is a citizen of some state and that the payment of taxes is an inherent part of being a citizen. Just as most organic theories of the state, it assumes the existence of political obligation without arguing for it. But it is important to see that the benefit justification for taxing a citizen at all might consistently be combined with the ability theory's determination of how much one ought to pay. That is, one might argue that a person is bound to make an equitable contribution to the support of a government once he has chosen to submit himself to its jurisdiction and therefore to claim at least minimally some of its protection, but recognize that that principle does not of itself determine in what an equitable contribution consists. The benefit justification, as I attempted to show above, is at its most elementary level based on the notion of consent; it does not lead inexorably to the second level of the theory, the *quid pro quo* determination of the amount of taxes. I have dwelt on this possible combination of the benefit justification and the ability determination of amount because I think it offers a rationale for the principles the courts have applied in balancing the equities in this field and in sustaining the taxation of nonresidents, as will be seen below.

If the receipt of benefits justifies the imposition of some tax, then clearly the central city is justified in taxing the nonresident commuter if it can legally do so. For the benefits the commuter receives are manifest. The benefits from living in a large metropolitan area generally stem from economies of scale in the production of various goods, either tangible governmental products or associational values. Larger cities can offer a larger variety of jobs, neighborhoods and churches; only a few cities are large enough to support good symphony orchestras; only New York is large enough to support four major political parties. Large aggregates of people cannot live in the close proximity required for the production of these goods without a great deal of government, because the aggregation of a great many people creates collective costs which would not exist if the people lived separately. For example, a million people on their own family farms may deposit sewage in their own septic tanks, but a million people living together must dispose of sewage so as not to create health hazards for one another, and creating a system which will handle that disposal requires organization. Furthermore, sewage disposal is a so-called public good: the public health benefit of the system accrues to everyone regardless of whether he contributes to the support of the system. Unless public goods are supported by compulsory contributions, they tend to be underproduced because it is not sufficiently in the interest of any one person to purchase his "share," much less to organize the effort. Commuters benefit directly from the municipal government because they consume public goods

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[48] MUSGRAVE, *supra* note 44, at 63.

during their working days: sewage, city streets, city police and fire protection, to name the most obvious examples. To a large extent the city government protects the environment in which it is possible for them to associate with large numbers of other people, which is the reason why most of them wish to live in a large metropolitan area.

Commuters also benefit indirectly by living in close proximity to central cities. For example, central cities invariably contain the high crime areas of SMSA's, and central city police prevent at least some of that crime from spilling over into suburban areas.[49] And central cities provide a basic education for residents' children, persons who are likely to be employed by suburban factory owners or managers.

As Break argues, a great many of central-city-produced benefits may spill out of the city to citizens well beyond the suburban fringe. Urban educated children may well migrate to other cities; even if they do not, it is of value to the whole nation to have a minimally educated electorate. But many of the benefits accrue more directly to the particular suburbs than to the state or nation at large (e.g. crime in New York City is more likely to spill over into Long Island than into Pasadena), and the suburbanites might well pay as such for the differential benefits they enjoy.

This brings us to the second economic question raised above: what sorts of fiscal arrangements will ensure optimal production of public goods for the metropolitan area as a whole? The benefit theory is widely suggested as a partial answer to this question. If government benefits are distributed upon payment of a price, then the market mechanism can help set the level of government production. Even if the payments are compulsory taxes, rather than prices, if they are paid in proportion to benefits consumed, the political mechanism will help to set the level of production. As Musgrave points out, this use of the benefit theory provides a theoretical solution to the allocation problem of public finance, the problem of deciding whether resources are being best employed in a particular government program or whether they should be used for another or returned to the private sector.[50]

Several practical difficulties arise with this theoretical solution, however. In the first place, some public goods are not consumed in measurable quantities, so the items cannot be priced. Secondly, as argued above, some items of government service are intended to be consumed in part without regard to one's ability to pay for them, e.g. public education. In the third place, the theory assumes too much of the political system; it is often not a very fine reflector of precise public wants in quantified terms. Break argues that because benefit spill-outs occur, local voters are likely to undersupport programs:

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[49] THE CHALLENGE OF CRIME IN A FREE SOCIETY, REPORT OF THE PRESIDENT'S COMMISSION ON LAW ENFORCEMENT AND ADMINISTRATION OF JUSTICE, Chapter 2, Section on *Crime and the Inner City* (1967).

[50] MUSGRAVE, *supra* note 44.

> Both [private and social benefits] of these become external whenever they are enjoyed by persons outside of the government jurisdiction that generated them. When this happens local voters, lacking any financial contribution from outside beneficiaries, are likely to undersupport the programs in question, thereby impairing economic performance by distorting the allocation of resources.[51]

In consequence of these difficulties, economists usually argue for using the pricing mechanism only where the goods financed and consumed are closely analogous to privately-produced goods and can be easily measured, e.g., use of water or downtown parking space. Lacking any fine-tuned economic mechanism for distributing the rest of the fiscal burden, they fall back on the equitable notion of ability to pay.[52] The political system is then left to determine by its own means the most efficient level of production.

The application of this theory in the metropolitan area is somewhat complex. Many economists agree that more user charges should be applied to the consumption of city services by commuters—for example, downtown on-street parking is woefully underpriced, especially if the city wants to encourage the use of mass transit facilities. As for general taxes there is the fact that commuters consume unmeasurable quantities of general city services; there is also the fact that, on the average, commuters are better able to pay taxes than central city residents. On the other hand, the commuter is almost always supporting a separate suburban school system and probably other government services as well. Various balances of the equities have been worked out, as will be shown below in discussing experience with the municipal income tax; but I believe it is correct to say that, at least at present, there is no consensus as to which particular splitting of the central city tax burden between residents and nonresidents is equitable.

III. *The Municipal Income Tax—Part of the Solution*

A number of cities have found a partial solution to their fiscal problems in the municipal income tax. In its typical form, the so-called Philadelphia type, the tax is a simplified version of the most common state personal income tax. That is, it taxes earned income of residents of the city regardless of where they earn it and the earned income of nonresidents which arises from sources in the city. (Cities also tax business income by and large, but that topic is beyond the scope of this paper.) Experience with the tax to date argues strongly that it can be for most cities a flexible progressive revenue instrument with few of the defects of the property tax.

In the first place such a tax enables the city to reach most of the in-

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51 BREAK, *supra* note 2, at 63-4.

52 *See*, J. Due, GOVERNMENT FINANCE 108 (3rd ed. 1963).

come of commuters, those suburbanites who derive the most direct benefits from services which the city provides. Although there has been a substantial migration of business beyond the city line, central cities still have far more than their share of metropolitan area employment. In 1963 the central cities of the forty largest SMSA's accounted for only 46 per cent of the population of those areas, but they retained 67 per cent of the wholesaling jobs, 69 per cent of the service jobs, and 49 per cent of the manufacturing jobs.[53] Earned income from wages and salaries represents the vast bulk of income reported for federal income tax, so the city could tax almost all of the income of those suburbanites who work in the city. Of course for some cities the percentage of in-city workers who commute is much larger than the average—in Boston the figure is near 40 per cent; for these cities the increase in tax base would be much more substantial.

Enforcement of the tax against nonresidents is no more difficult than against residents. All of the estimated tax can be withheld at the source. Furthermore, the courts have aided in the collection of the tax from residents who commute out from the city by sustaining a withholding requirement imposed on outside employers.[54] And in fact the tax has been quite successful in garnering large increments of revenue from nonresidents in those cities which have already adopted it. Nonresidents provide 15 per cent of Philadelphia's income tax revenue, 25 per cent of St. Louis's, 40 per cent of Lexington's, and 20 per cent of Dayton's.[55] Mayor Lindsay hopes to increase significantly the revenue under the New York City income tax by increasing the rates on commuters and simplifying the procedure.[56]

The income tax should provide revenues that expand faster than the increase in GNP and much faster than the increase in property tax revenue without the political embarassment of raising rates. The ACIR has estimated its GNP yield elasticity at between 1.5 and 1.8, the lowest estimate being considerably higher than the best estimate for the property tax.[57]

It is unlikely that the enactment of the tax will lead to increased migration of residents out of the city. Barlow, Brazer, and Morgan's study of the *Economic Behavior of the Affluent* for the Brookings Institution tested the tax consciousness of a sample of persons with 1960 incomes of

[53] Kain, *supra* note 34, at 27.

[54] *See* Dole v. Philadelphia 337 Pa. 375, 11 A.2d 163 (1940).

[55] Robert A. Sigafoos, THE MUNICIPAL INCOME TAX: ITS HISTORY AND PROBLEMS 79 (1955), Table XII. Recent data do not appear to be available. The Tax Foundation in its 1967 study noted the absence of such data, except from Cincinnati and Detroit. Cincinnati collects 34 to 38% of its income tax revenue from nonresidents; for Detroit, the figure has ranged between 29 and 18%. *City Income Taxes*, 38 TAX FOUNDATION, INC. (1967).

[56] N.Y. Times, Apr. 10, 1970, at 1.

[57] BREAK, *supra* note 2, at 18.

$10,000 or more. More than 22 per cent of those questioned did not even know their marginal tax rate for federal income tax purposes. Specifically questioned about state and local taxes, only half believed taxes were higher where they lived than in other places where they might conceivably live, only one sixth of that half had even thought of moving on account of taxes, and only one sixth of that sixth said they probably were going to move on account of taxes.[58] It is submitted that far fewer people among the less affluent would consider moving for tax reasons.

Economists' concern about the possible effects of widespread enactment of the tax has centered on the possibility that corporations will be subject to multiple taxation in all of the cities in which they might desire to locate and that this will distort their locational choices.[59] While the corporate municipal tax is not within the scope of this paper, it should be noted that if cities have a uniform income allocation formula (and they are required by federal constitutional law to make some allocation), the tax will not affect locational choices. Furthermore, as argued above, the property tax is probably a much greater problem for businesses considering relocating in the city or expanding there.

Insofar as the property tax currently constitutes a disincentive for remaining in the central city, adoption of the income tax would permit cities to give some property tax relief. Ohio cities, some of which have had the tax for more than twenty years, have come to rely upon it for larger and larger proportions of their total tax revenue; it produces more than 59 per cent in Columbus, Dayton, and Toledo. Detroit gets over 30 per cent from the tax, Philadelphia gets 46.6 per cent, and Louisville and Lexington both get over 50 per cent.[60] With the exception of Detroit, property taxes are considerably lower in income tax cities than in other cities of comparable size, and the rate of increase in the property tax has been less.[61] With the pressure on the property tax somewhat relieved, the city would be able to engineer incentives for new construction into the property tax structure; without any such incentives, Columbus was one of only three older cities in the country to increase manufacturing employment by more than 10 per cent from 1958 to 1963, and Cincinnati and Louisville were two of only three central cities which did better than their surrounding outside areas.[62] Discussion of such incentives is, however, beyond the scope of this paper.

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[58] R. BARLOW, H. BRAZER, and J. MORGAN, ECONOMIC BEHAVIOR OF THE AFFLUENT 160, 169-70 (1966).

[59] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *State Constitutional and Statutory Restrictions on Local Taxing Powers* 12 (1962). ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *supra* note 4, at 101-02.

[60] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *supra* note 4, at 95-6.

[61] TAX FOUNDATION, *supra* note 55, at 29-31. *Cf.* Sigafoos, *supra*, note 54 at 87.

[62] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS. The Columbus figure may be influenced by annexations, *supra* note 8, at 53.

Costs of administration of the municipal income tax are moderate.

> In Pennsylvania local taxing districts, including counties and school districts as well as cities, the average cost of collection for all jurisdictions in 1961 was 4.4 per cent of revenue. The average cost for the smallest jurisdictions was 6.0 per cent, gradually dropping to 3.9 per cent for the largest units, suggesting scale economies. Administrative costs in about the same range have been reported for Ohio. The research director of the Ohio Municipal League has estimated that costs generally run between 2 and 5 per cent of collections.[63]

As the tax comes to be relied upon more and more, administrative costs as a percentage of collections should decline because merely raising the rate should not impose additional costs. On the other hand, most municipalities have been very lax in attempting to enforce the statute against evaders, particularly residents commuting out; they have been content to rely on the efficiency of the withholding provisions to produce large amounts of revenue without spending the additional funds to catch evaders.[64] This causes obvious inequities, but no one seems to have estimated the costs of greatly improved enforcement. Similarly, increased administrative costs must be considered closely when expansion of the tax to unearned income is contemplated. Most large-city administrators thought in 1955 that the costs would be prohibitive.[65] Whether they have decreased by now would probably depend on whether cities could work out cooperative arrangements with the Internal Revenue Service or state departments of taxation. Mayor Lindsay was unable to get state collection of the New York City tax because, apparently, Governor Rockefeller feared people would think it was an additional state tax and blame him for it politically.

The manifold advantages which the municipal income tax exhibits have led to its increasingly widespread adoption in the last ten years. The first city income tax was enacted by Philadelphia in 1939 under authority granted to that city alone by the Sterling Act, passed by the Pennsylvania legislature in 1932 when Philadelphia was near bankruptcy. In 1948 Pennsylvania passed the so-called "tax anything" act which permitted local governments to tax any revenue source which was not preempted by the state. Under the authority of that act, numerous Pennsylvania local jurisdictions have enacted the tax. The city of Toledo, Ohio, acting under its presumed home rule authority, enacted an income tax ordinance in 1946; Columbus, Dayton, Warren, Youngstown, and Springfield, Ohio, followed within three years. St. Louis received a special enabling act in 1948 and put the tax in, but the only large cities to adopt the tax in the

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[63] *Municipal Income Taxes*, The Proceedings of the Academy of Political Science, Vol. XXVIII, No. 4, chapter on administration, 1968. *Cf.* Sigafoos, *supra* note 55, at 61.

[64] *Id.* at 57.

[65] *Id.* at 67.

fifties were Cincinnati and Pittsburgh, both following the lead of sister cities. In the sixties, however, the proportion of large-city population covered by the tax leaped from 14.6 per cent to over 40 per cent with adoptions in Detroit (1962), Baltimore and New York (1966) and Cleveland (1967).[66] At the same time, the tax continues to spread among smaller jurisdictions in Ohio and Pennsylvania, so that 86 per cent of the jurisdictions imposing the tax are still located in those states.

The length of time which the tax has been in use has permitted the development of a fairly extensive body of case law governing its use. It is to that law that we now turn.

IV. *Federal Constitutional Standards Governing the Use of the Municipal Income Tax*

It was argued above that two basic questions concern the public finance theorist, the equity of the distribution of the tax burden (based on standards for the distribution of wealth in general), and the effect of taxes upon the allocation of resources. It was demonstrated that it is fair for the city to tax the commuter and necessary to do so if city services are not to be underproduced. But the city's needs are not the only ones, nor are they legally paramount. There are competing equitable and economic interests which deserve recognition.

With regard to the equity question, there is the general ethical interest that persons similarly situated be treated equally. This implies a presumption against discrimination among persons unless a reasonable basis for classifying them can be demonstrated. Hence on the face of things one would question a city tax which levied a higher rate on commuters than on residents. Similarly, a city might carry the benefit justification to an inequitable extreme and try to tax persons who received only diffuse and remote benefits from city services.

The competing economic interest is the ideal of free trade. Economists since at least Adam Smith have argued for the elimination of trade barriers between governmental jurisdictions. The advantages are twofold: each location or area can concentrate on producing those goods in which it enjoys a comparative advantage over other areas. Secondly, mobile factors of production—capital and labor—can move freely to those locations where they are needed most.

The tax best designed not to affect locational decisions is a national net income tax levied on profits after locational decisions have been made. A uniform state net income tax would have virtually the same locational effect. Barring that, a state system of user charges or benefit-measured taxes would have little distorting effect.

Several constitutional clauses seem fit receptacles for these standards.

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66 The history related in this paragraph is all taken from the Tax Foundation study.

The privileges and immunities clause is directly targeted at preventing discrimination by States against nonresidents (at least those nonresidents who are citizens of other states). The equal protection clause is designed to prevent states from classifying their own citizens for different treatment upon arbitrary or unreasonable grounds.

The due process clause, in addition to its many other burdens, has been interpreted as a general limitation upon the exercise of jurisdiction by the States.[67] The reason seems to be that the notion of sovereignty is inextricably linked in American legal thought to territoriality. Cooley in THE LAW OF TAXATION[68] puts the matter this way: "The political jurisdiction of a state does not extend beyond its territorial limits, and therefore it cannot lawfully impose taxes upon persons, natural or artificial, or property, residing or situated beyond such limits." Judge Cooley (or his editor) cites a number of cases holding that an attempt to tax beyond state boundaries is a taking of property without due process of law.[69] The reason for the rule, it is said, is the 'want of jurisdiction' or 'lack of legal interest in the subject'—both of which phrases are conclusory and assume that sovereignty is necessarily territorial. For these reasons Cooley criticizes several cases permitting cities to tax land adjacent to them, even though he admits that the cities may have conferred benefits on the land, because the cities were not authorized to expend money so as to benefit that land.[70] When the courts rely upon the benefit justification for taxation, they seldom make it as clear as Cooley does here that territoriality is a limit on that justification.

The Supreme Court has often declared "that the commerce clause was intended to secure free trade among the United States."[71] Insofar as free trade is now our constitutional policy, states taxes must be judged according to the amount of interference with free trade which they create. The important result is not that income from interstate commerce go untaxed, but that taxes not make it more expensive for a firm or individual to operate interstate than intrastate.

On balance, it is the conclusion of this study that the courts have found the equity and due process standards more manageable than the commerce clause standard. It is easy to understand why. Discrimination against nonresidents often appears on the face of much state tax legislation which the Supreme Court has invalidated. And, the Court can judge relatively simply when a state is attempting to tax a nonresident upon the basis of some remote intangible benefit it has conferred.

But the free trade standard emerges from the commerce clause only by

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67 *See*, e.g., Hanson v. Denckla, 357 U.S. 235 (1958).
68 Cooley, *supra* note 32 at 218.
69 *Id.* at 222.
70 *Id.* at 224.
71 Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

negative implication.[72] The taxing statute may display no evidence of an attempt to favor local commerce and hence any adverse effect on interstate commerce will have to be found by delicately weighing the tax's consequences. Judges must do this balancing against the well known backdrop of state fiscal difficulties. Finally, the adverse effect on interstate commerce may consist of the cumulative effect of a number of state taxes, none of them unfair in itself. The remedy in such a case is not clear; is the Court to strike down one or both taxes or is it to revise the rates or credits as they apply to one particular company?

> [I]f the statute involved were not in itself unreasonable, to declare it invalid because of its contribution to multiple taxation would make the constitutionality of one state's statute depend upon other states' taxes and upon the taxpayer's decision as to which statute he wished to challenge. To strike down all statutes contributing to multiple taxation, even though none of them was unreasonable, would require extensive litigation and would result in a complete exemption for those interstate businesses willing to bring suit. . . . [I]t seems doubtful . . . that a test based on actual multiple taxation is workable. . . .[73]

The approach of the Court in applying the commerce clause to these cases is best summed up in Mr. Justice Frankfurter's opinion in *Northwestern States Portland Cement Co. v. Minnesota*:[74]

> While it is true that a state may not erect a wall around its borders preventing commerce an entry, it is axiomatic that the founders did not intend to immunize such commerce from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State. . . .[75]

In the same case the Court replied to the suggestions that such a tax might result in multiple taxation by saying "none is shown to exist here."[76] The Court made no suggestion as to how it would or could handle a case which did show multiple taxation (that is, taxation of more than 100 per cent of the same base by a combination of states).

In addition, the Court has spelled out its reluctance, at least in recent years, to interfere with state taxation which does not involve gross discrimination. Mr. Justice Frankfurter in *Wisconsin v. J. C. Penney Co.*:[77]

> At best, the responsibility for devising just and productive sources of revenue challenges the wit of legislators. Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making.[78]

[72] 75 HARV. L. REV. 953, 1018-19, 956 (1961).
[73] *Developments*, *supra* note 72, at 1018-19.
[74] 358 U.S. 450.
[75] *Id.* at 461.
[76] *Id.*
[77] 311 U.S. 435 (1940).
[78] *Id.* at 445.

The Court announced the standards by which it would judge taxes under the privileges and immunities clause in *Ward v. Maryland*.[79] Maryland imposed a license requirement upon traders with a sliding scale fee of $12 to $150 for residents and a flat $300 for nonresidents. Justice Clifford began by reciting the sovereignty/territoriality basis of the taxing power:

> Outside of the prohibitions, express and implied, contained in the Federal Constitution, the power of the States to tax for the support of their own governments is coextensive with the subjects within their unrestricted sovereign power. . . .[80]

This power clearly implies that nonresidents may be taxed:

> Reasonable regulations for the collection of such taxes may be passed by the States, whether the property taxed belongs to residents or nonresidents; and, in the absence of any Congressional legislation upon the same subject, no doubt is entertained that such regulations, if not in any way discriminating against the citizens of other States, may be upheld as valid; . . .[81]

But the particular tax in question was invalid because it clearly discriminated against nonresidents in violation of the purpose of the privileges and immunities clause:

> . . . the [privileges and immunities] clause plainly and unmistakably secures and protects the right of a citizen of one State to pass into any other State of the Union for the purpose of engaging in lawful commerce, trade, or business without molestation; to acquire personal property; to take and hold real estate; to maintain actions in the courts of the State; and to be exempt from any higher taxes or excises than are imposed by the State upon its own citizens.[82]

The principles of federal constitutional law by which municipal income taxes are judged when applied to interstate commuters have been laid down in cases dealing with state income tax laws. The cases are clearly applicable to municipalities, for what a state cannot do itself, it cannot permit its instrumentality to do.

The Oklahoma state income tax was the first to reach the Supreme Court in the case of *Shaffer v. Carter, State Auditor*.[83] Oklahoma imposed a tax very similar in incidence to most state and local income taxes since enacted. The first section of it read:

> Each and every person in this State, shall be liable to an annual tax upon the entire net income of such person arising or accruing from all sources during the preceding calendar year, and a like tax shall be levied, assessed collected and paid annually upon the entire net income from all property

[79] 79 U.S. (12 Wall.) 418 (1870).
[80] *Id.* at 428.
[81] *Id.*
[82] *Id.* at 430.
[83] 252 U.S. 37 (1920).

> owned, and of every business, trade or profession carried on in this state by persons residing elsewhere.[84]

Shaffer was a resident of Chicago and owned certain oil lands and leases on oil lands in Oklahoma. Making the full range of constitutional arguments, he contended that the tax as applied to nonresidents took property without due process of law, denied the equal protection of the laws, burdened interstate commerce, and "discriminates against non-residents in favor of residents, and thus deprives plaintiff and other non-residents of the privileges and immunities of citizens and residents of the State of Oklahoma . . ."[85] The Court interpreted his argument as being that the right to do business in a state as a nonresident was a privilege protected from interference by the Federal Constitution, by one or all of the clauses cited. The Court's reply, from the pen of Mr. Justice Pitney is worth considering at length because it summarizes the principles which have since governed litigation in this area. As to Shaffer's argument, the Court said:

> This radical contention is easily answered by reference to fundamental principles. In our system of government the States have general dominion [sovereignty?], and, saving as restricted by particular provisions of the Federal Constitution, complete dominion over all persons, property, and business transactions within their borders. . . .[86]

The basic premise, then, is the sovereignty of the states, their continued power to act as complete or supreme governments unless restrained by the Constitution.

> . . . they assume and perform the duty of preserving and protecting all such persons, property, and business . . .[87]

Sovereignty is not just power; it implies certain obligations on the part of the sovereign, the maintenance of the order in which commerce can take place—to wit, governing.

> . . . and, in consequence, have the power normally pertaining to governments to resort to all reasonable forms of taxation in order to defray the governmental expenses.[88]

These statements may seem like perfectly straightforward political philosophy, but they contain, I submit, two different premises justifying the taxation. The state is a sovereign government with jurisdiction of all events taking place within its borders; it has the powers pertaining to the concept "government," including taxation. The other premise is that the state assumes the duty of protecting commerce—i.e. it confers a benefit on certain

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[84] *Id.* at 44.
[85] *Id.* at 46.
[86] *Id.* at 50.
[87] *Id.*
[88] *Id.*

persons—and "in consequence" has the power of taxation. The Court later in the opinion speaks of "the state, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible . . ." The first of these premises reflects what Seligman called the organic theory of the state,[89] the latter, the benefit justification based on the supposed contractual nature of the state. These two premises, when extended to more difficult cases, might yield different results if the Court saw them as different premises. That is, if the power to tax really depended upon the conferring of benefits, the Court might conceivably inquire whether in fact the state did confer benefits in the particular case before it; the Court might even have come to suggest that the tax be somehow proportioned to the benefits, employing the second level of the benefit theory. For example, it might have insisted that, at least in taxing nonresidents, the state employ benefit-oriented user charges to the fullest extent practicable. On the other hand, the sovereignty principle, as suggested by the phrase "general dominion," suggests a sort of omnipotence of the state within its borders and suggests that the power of taxation is one of the many incidents of this power. In contrast to the limits which the benefits premise might imply, the sovereignty premise is linked, as noted above, to the notion of territoriality. One would expect taxation based upon sovereignty to be limited to those persons with some sort of minimal geographical contact with the state.

Ordinarily deriving benefits from state government requires having some minimal geographical contact with it. But as noted above from Break, state and local governments may produce significant benefits which "spill out" of the jurisdiction in which they are created. Carrying the benefits principle to its extreme might permit taxation extraterritorially, at least where significant benefits are conferred. On the other hand, sovereignty might permit taxation of someone passing through the state and deriving no benefits from the taxing government.

The Court has occasionally expressed the benefit rationale in language which makes it seem that the presence of some benefit is a constitutional *sine qua non* of taxation. For example, Mr. Justice Frankfurter in *State of Wisconsin v. J. C. Penney Co.*[90]

> A state is free to pursue its own fiscal policies, unembarassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.
>
> [The sole constitutional test is] whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given

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[89] *Id.* at 14.

[90] 311 U.S. 435 (1940).

> by the state. The simple but controlling question is whether the state has given anything for which it can ask a return.[91]

When litigants attempt to use this doctrine as a sword to attack state taxes instead of as a shield for protecting, they are brought up short. In *Capitol Novelty Co. v. Evatt*,[92] the operator of a slot machine business claimed he could not be taxed (personal property tax) because slot machines are illegal in Ohio and therefore receive no protection from the state. The Ohio Supreme Court answered with a long quotation from *Carmichael v. Southern Coal and Coke Co.*[93]

> A tax is not an assessment of benefits . . . [but] a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. See *Cincinnati Soap Co. v. US*, [301 US 308] Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, ... This Court repudiated the suggestion, whenever made, that the Constitution requires the benefits derived from the expenditure of public moneys to be apportioned to the burdens of the taxpayer. . . .[94]

The Court's approach seems to be to make the conferring of benefits the justification for taxing, to presume that benefits have been conferred (perhaps irrebuttably) when there is territorial jurisdiction, but to limit the benefit justification to cases where territorial jurisdiction exists.

The Court does not deal with the fact that in taxing nonresidents for the benefits conferred upon them, the state is taxing upon the basis of rights which it is constitutionally bound to acknowledge. It may not exclude commuters; it cannot condition their entry upon their ability to pay taxes;[95] but if they use their right and subject themselves to the territorial jurisdiction, they can be required to pay.

In the *Shaffer* case, after setting out the premises just discussed, Mr. Justice Pitney proceeds to consider the propriety of the income tax in particular. He notes *McCulloch v. Maryland*[96] for the proposition that states have the "widest liberty" in the choice of taxes. Income taxes come within this liberty:

> Certainly they are not restricted to property taxation, nor to any particular form of excises. In well-ordered society, property has value chiefly for what it is capable of producing, and the activities of mankind are devoted largely to making recurrent gains from the use and development of property, from tillage, mining, manufacture. . . . That the State . . . is

[91] *Id.* at 444.
[92] 145 Ohio St. 205, 61 N.E.2d 211 (1945).
[93] 301 U.S. 495 (1936).
[94] *Id.* at 522.
[95] Edwards v. California, 312 U.S. 160 (1941).
[96] McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

> debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop . . . the business but not the profit derived from it, is wholly inadmissible.[97]

Pitney cites the value to the states of income taxes in particular: they exact payment from those who have realized current gain and they are readily proportioned to ability to pay.

Next the Court specifically addresses the privileges and immunities point. It grants that a state may not deny to citizens of other states the right to carry on a business within its borders, at least to the extent it grants that right to its own citizens.

> . . . but it does not follow that the business of nonresidents may not be required to make a ratable contribution in taxes for the support of the government. On the contrary, the very fact that a citizen of one State has [such a] right . . . is a very reasonable ground for subjecting such non-resident . . . to a duty to pay taxes not more onerous in effect than those imposed under like circumstances upon citizens of the latter state. . . . It protects him against discriminatory taxation, but gives him no right to be favored by discrimination or exemption. See *Ward v. Maryland*, 12 Wall. 418, 430.[98]

Justice Pitney points out that the United States imposes a similar tax on the income of nonresidents earned in this country, "And, so far as the question of jurisdiction is concerned, the due process clause of the Fourteenth Amendment imposes no greater restriction in this regard upon the several States than the corresponding clause of the Fifth Amendment imposes upon the United States."[99] The fact that the income was produced at least in part by Shaffer's personal effort, which might be thought to be located in Chicago, was held immaterial, for Oklahoma's power over the source of the income was said to be "*in rem*."[100] The Court also cited as consistent with its decision prior opinions sustaining intangible personal property taxation, in the debtor's state, of credits due a nonresident creditor.[101]

Shaffer also contended that there was a deprivation of privileges and immunities in that residents of Oklahoma could deduct from gross income all losses, wherever incurred, whereas nonresidents could only deduct losses which occurred in Oklahoma. The Court also rejected this argument, saying that the discrimination was only reasonable since Oklahoma could only tax income from sources within the state. The Court states here

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97 Shaffer v. Carter, 252 U.S. 37, 50 (1920).

98 *Id.* at 53.

99 *Id.* at 54. *See*, DeGanay v. Lederer, 250 U.S. 376 (1919), sustaining federal taxation of the income of a nonresident alien derived from securities held in this country.

100 Shaffer v. Carter, 252 U.S. 37, 55 (1920).

101 *Id.* at 52.

what it implies elsewhere—Oklahoma cannot impose its taxes extraterritorially.

The Court disposes of the argument that the tax burdens interstate commerce without argument. Since the tax is on net income rather than gross receipts, it is constitutional even if it includes income from interstate commerce, under the decision in *U.S. Glue Co. v. Oak Creek.*[102] Note that the Court makes no estimate of how much in fact this levy may burden interstate commerce.

In the *U. S. Glue Co.* case the plaintiff questioned, on commerce clause grounds, that portion of the Wisconsin net income tax which was applied to its income from interstate sales. Justice Pitney for the Court distinguished between the direct burden on interstate commerce of a gross receipts tax and the "indirect and incidental" burden of an apportioned net income tax. (The intricacies of state apportionment formulae for corporate net income are beyond the scope of this paper.) A gross receipts tax has a deterrent effect on commerce because it represents an additional cost of doing business; a net income tax is imposed only if the business is otherwise profitable—hence it does not deter interstate commerce:

> Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property [actually it is less deterrent than a property tax], or upon franchises treated like property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the States are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States.[103]

Note that the Court does not consider the possible deterrent effects of cumulative net income taxes where, because of non-uniform definitions of residence or apportionment formulae, the same net income is taxed "doubly," that is, at a greater rate than would be the case if the same volume of business were done in one state. Instead, the Court imports a privileges and immunities sort of test into the commerce clause: the tax is to be upheld if it does not "discriminate" against interstate commerce.

On the same day as *Shaffer v. Carter*, the Court considered the provisions of the New York state income tax as applied to nonresidents in the case of *Travis v. Yale & Towne Mfg. Co.*[104] Plaintiff was a New York employer of residents of Connecticut and New Jersey. The tax was similar to that of Oklahoma with several additions:

1. It exempted from the taxable income of nonresidents annuities and

[102] 247 U.S. 321 (1918).
[103] *Id.* at 329.
[104] 252 U.S. 60 (1920).

interest on bank deposits and interest bearing obligations arising from New York sources.

2. It limited all business deductions of nonresidents to those incurred with respect to New York source income. (*Shaffer* discusses only a loss deduction.)
3. Exemptions of $1,000 to an individual and $2,000 plus $200 per dependent to a family were allowed only for residents.
4. Where a nonresident was the citizen of another state which imposed an income tax on the income taxable under the New York law, the nonresident was granted a credit on the New York tax equal to the proportion of that tax which the nonresident's New York source income bore to his whole income, if the other state granted a similar credit to New Yorkers.

The plaintiff raised all of the constitutional questions which had been raised in *Shaffer*, but abandoned the commerce clause argument on appeal. (The equal protection argument does not seem to have been seriously urged or considered in either case.) The Court considered the due process question to be governed by *Shaffer*.[105] It considered the privileges and immunities argument as similarly governed.[106] Indeed, the argument seems much clearer when the deduction is of the New York type—expenses incurred in the production of income ought to be deductible only with regard to that income.

Yale & Towne's obligation to withhold the taxes was upheld as a reasonable exercise of New York's power to regulate corporations doing business within its borders.[107]

Having come this far, the Court invalidated the tax because it discriminated between residents and nonresidents in the granting of exemptions, a discrimination said to violate the privileges and immunities clause.[108] The basic purpose of the clause is to permit citizens of one state free ingress to and egress from other states and the right to pursue the same occupations as citizens of those states, and not to be subject to higher taxes or excises than those to which the state subjects its own citizens. The Court rightly noted that the exemption would result in a higher tax for nonresidents. While "nonresident" is a broader term than "citizen," the language of the clause, discrimination against nonresidents necessarily comprehends discrimination against citizens of other states. The inequality is not accidental or due to the peculiar individual circumstances of the particular taxpayers, but operates generally on all citizens of other states who work in New York, of whom, as the Court noted, there are many.

The discrimination was attempted to be justified by pointing to the

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105 *Id.* at 75.
106 *Id.*
107 *Id.* at 76.
108 *Id.* at 77-8.

partial exemption of New York source income for nonresidents. The Court found that this benefit was not at all proportioned to the exemption discrimination and was in fact probably intended "to preserve the preeminence of New York City as a financial center."[109]

Finally, New York's attorney general argued that it was expected that the adjoining states would soon enact income taxes of their own and would grant particular exemptions to residents. The Court replied that that was wholly speculative and that at any rate discrimination was not cured by retaliation.[110] Justice McReynolds, who had dissented in *Shaffer* without opinion, concurred in the result, again without opinion.

Following the *Travis* case, the New York statute was amended to permit exemptions for nonresidents. It continued to allow nonbusiness "personal" deductions only to residents. This provision was challenged under the privileges and immunities clause by a New Jersey resident and upheld in *Goodwin v. State Tax Commission*.[111] The court held that the *Travis* decision was still binding, but that it did not invalidate the deduction provisions. It reasoned that deductions for personal expenditures amounted to a limited subsidy of the particular activity by the state, and that a state is permitted to give subsidies to encourage the welfare of its residents without granting similar subsidies to nonresidents.[112] Furthermore it argued that not every discrimination between residents and nonresidents is unreasonable and so the test was "whether the factor of residence has a legitimate connection with the allowance of these deductions, so that a classification on the basis of residence is justifiable.[113] Thus the New York court imports an equal protection clause standard into the interpretation of the privileges and immunities clause. It concludes that there was a legitimate connection in that personal expenses must be deemed (or might reasonably in the exercise of legislative judgment be deemed) to be made by a person in his state of residence, "the state in which his life is centered." It distinguishes the exemptions decided upon in *Travis* on the ground that they amount to a flat reduction of the tax and hence were constitutionally the same as imposing a higher rate on nonresidents, the same analysis offered by Justice Pitney in *Travis*. It points out that the deductions involved here are not flat amounts, that the taxpayers had actually to expend the money, and that in lieu of the itemized deductions the statute permits a flat 10 per cent standard deduction to residents and nonresidents alike. The court does not deal with the problem which would be raised if a person were considered a resident by more than one state at a time, for example, if his life centered in each of them for six

109 *Id.* at 81.
110 *Id.* at 82.
111 146 N.Y. S.2d 172 (1955).
112 *Id.* at 180.
113 *Id.* at 179.

months of the year. If such a definition of residence is reasonable, then such a person might be subject to double taxation or conversely, as in this case, able to claim the deduction with equal justification for either place and therefore legally for both places.

State decisions on the federal questions raised by municipal taxation of nonresidents have followed *Shaffer v. Carter* rather closely as to the basic benefit rationale of the taxation. But the state courts have been more careful, at least in some instances, to point out the actual benefits enjoyed by the particular taxpayer-litigant.

The first state case involving a city income tax was *Kiker v. Philadelphia*.[114] Plaintiff was a resident of New Jersey employed at the federal Philadelphia Navy Yard on League Island. Exclusive jurisdiction of the island had been ceded to the United States by Pennsylvania, but Congress in 1940 permitted taxation of persons working in federal areas.[115] The plaintiff contended that he was taxed on his salary from the Navy Yard without due process because he received "no benefits or protection" from the city. The court accepted his premise that benefits must be given or at least that the taxing authority must be obligated to give them:

> It is clear that in classifying persons for taxation an obligation on the part of the taxing power to make available some benefit to them must exist.[116]

But Philadelphia is obligated to confer benefits upon Navy Yard employees, contrary to what plaintiff seems to have thought:

> There is no doubt that after the cession, Philadelphia was obligated to confer all the usual attributes of government—the same as those possessed by residents and citizens of Philadelphia—upon those deriving income from working on League Island; fire and police protection, the right to use all municipal facilities, etc. This obligation can be called into play at any time the national government refuses or neglects to furnish them.[117]

And in fact, the court noted, the city kept the Philadelphia River clear of ice so that the plaintiff could use a ferry to get to work.

In *Angell v. City of Toledo*,[118] the Ohio Supreme Court made short work of a due process claim by a nonresident of Toledo against that city's income tax. Quoting the broad language of Justice Frankfurter in *Wisconsin v. J. C. Penney Co.*,[119] the Court found a number of benefits actually conferred upon the plaintiff:

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114 346 Pa. 624, 31 A.2d 289 (1943).

115 *See* 4 U.S.C. 14. This case required the Pennsylvania court to interpret the federal tax statute to reach the decision that it was intended to permit the taxation of Kiker and others similarly situated. Chief Justice Maxey dissented on this point.

116 Kiker v. Philadelphia, 346 Pa. 624, 31 A.2d 289, 294.

117 *Id.*

118 153 Ohio St. 179, 91 N.E.2d 250 (1950).

119 311 U.S. 435 (1940).

> The municipality certainly does afford protection against fire, theft, et cetera, to the place of business of plaintiff's employer and the operation thereof without which plaintiff's employer could not as readily run its business and employ help. In other words, the city of Toledo does afford to plaintiff not only a place to work but a place to work protected by the municipal government of Toledo.[120]

The opinion is very unsatisfactory because the court does not say whether plaintiff lived inside or outside of Ohio. If he lived outside of Ohio, the court was merely deciding the simple federal question upon which *Shaffer* is good authority. If, on the other hand, the plaintiff lived inside of Ohio, the court might have been deciding to incorporate the federal territoriality/due process standard into state law (a state law question) or it might have been deciding a novel federal point—that is, that the federal due process clause forbids the states to permit municipalities to tax extraterriorially. Without knowing where the plaintiff lived, it is impossible to tell which of these questions was being decided.

In *Arnold v. Berra*,[121] the plaintiff, a resident of Illinois, raised the federal due process/lack of benefits and commerce clause arguments. To refute the due process claim, the Missouri Supreme Court adopted *Kiker* and *Angell* as stating the controlling law.[122]

With regard to the commerce clause, plaintiff argued that Illinois and its political subdivisions duplicated this tax by sales and franchise taxes and also that he should be allowed to deduct the expenses of interstate commuting. The court replied that state taxation of nonresidents had been upheld in *Atkinson v. State Tax Commission*[123] and that all the events upon which the tax was occasioned occurred in Missouri. On balance it seems that neither the court nor the plaintiff advanced the discussion very much.

Finally, there is *Dooley v. City of Detroit*,[124] also in 1963. The plaintiff raised due process claims under both the Michigan and federal constitutions, but it does not appear from the opinion whether the plaintiff was a resident or nonresident of Michigan or of Detroit. The court relied on the holding in *Lawrence v. State Tax Commission*,[125] that a state may tax the extra-state activities of its own residents. As to nonresidents, the court merely cited *Shaffer*.[126]

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120 Angell v. City of Toledo, 153 Ohio St. 179, 91 N.E.2d 250, 253 (1950).

121 366 S.W.2d 321 (Mo. 1963).

122 *Id.* at 323. *Cf.* Walters v. St. Louis, 364 Mo. 56, 259 S.W.2d 377 (1953).

123 303 U.S. 20 (1937).

124 370 Mich. 194, 121 N.W.2d 724 (1963).

125 286 U.S. 276 (1932).

126 370 Mich. 194, 121 N.W.2d 724, 736 (1963).

V. *State Standards Governing the Use of the Municipal Income Tax*

A. *Permissions and Prohibitions*

In addition to meeting federal constitutional standards, municipalities must find authorization for their income taxes in state law. The proposition that local government is the creature of the state and entitled to exercise only so much authority as the state legislature has granted it is firmly entrenched in state constitutional law. Not even the strongest advocate of municipal autonomy the American Municipal Association, has suggested that municipalities be in any way sovereign.[127] The implication of state sovereignty is of course, the need to find some state authorization for the exercise of local power.

Because taxation is such an important political issue at the state level of politics, state legislatures have never given away their power to regulate local taxation.

> On the revenue side these demands [for autonomy in local financial affairs] have been singularly unsuccessful, at least at the level of constitutional theory. Although the precise rationale varies among the states, the result appears virtually everywhere to be the same: both the type and rate of local taxation are subject to legislative control.[128]

State control is only somewhat muted by constitutional home rule, as will appear below.

The municipal income tax is constitutionally forbidden in four states. In Tennessee, Article XI, section 9 of the constitution forbids the general assembly to authorize any municipality to levy an income tax.[129] The Florida constitution forbids the income tax to both state and local governments.[130] In Virginia the constitution in one section says that tax sources shall be split between the state and local governments; in a separate section it authorizes the state to levy an income tax. The legislature has interpreted this to mean that no local income tax may be levied, and has passed a statute to that effect.[131]

In Colorado the constitution authorizes the legislature to impose a state income tax.[132] In *City and County of Denver v. Sweet*,[133] the Colorado Supreme Court interpreted this section as pre-empting the income tax for the state, in the absence of use of the power by the state legislature and in

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[127] Cohn, *Municipal Revenue Powers in the Context of Constitutional Home Rule*, 51 Nw. U.L. Rev. 27, 28-9 (1956).

[128] Michelman & Sandalow, *Materials on Government in Urban Areas* 422 (St. Paul 1970).

[129] Advisory Commission on Intergovernwental Relations, *supra* note 59, at 81.

[130] *Id.*

[131] *Id.*

[132] *Id.* at 82.

[133] *Id.*

the absence of legislation forbidding local income taxes. The case is correctly criticized by Hartman, in his article on municipal income taxation.[134] Absent any legislative history (and none is cited by the court), the constitutional intent to preclude the city by authorizing the state is constructed out of whole cloth. Hartman rightly comments that the purpose of an authorization is to finance one government, not to deny another government authority to finance itself.[135]

No state constitutions explicitly authorize the tax.[136]

Explicit statutory prohibitions of local income taxes exist in Alaska, Kansas, North Carolina, South Dakota, Virginia (as legislative interpretation of the constitution), and Wisconsin.[137]

Without relying upon specific constitutional provisions, local attempts to levy taxes without explicit enabling legislation have been invalidated upon the authority of Dillon's Rule.[138] In Alaska the attorney general denied municipalities the power to levy gasoline taxes.[139] A similar holding by the Oregon Supreme Court occurred in *Eugene Theater Co. v. Eugene.*[140] These rulings would seem to encompass income as well as other types of taxes.

In *Carter Carburetor Corp. v. St. Louis,*[141] the Missouri Supreme Courut relied upon its own version of Dillon's Rule to invalidate the St. Louis city income tax. The rule had been stated in *Kansas City v. Frogge,*[142] that no tax could be imposed by a city unless clearly authorized by the city charter, the state constitution, or a general statute.[143] The city relied upon a general authorization in its charter which permitted it to "assess, levy and collect taxes for all general and special purposes on all subjects or objects of taxation."[144] The court replied that the city's interpretation of that clause was inconsistent with the later specific grant in the same charter of the power to levy license and some excise taxes.[145] Furthermore, such a

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134 Hartman, *Municipal Income Taxation,* 31 ROCKY MT. L. REV. 123, 147 (1959).

135 *Id.* at 147.

136 ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *supra* note 59, at 81.

137 *Id.* at 82.

138 "It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers, and no others: First, those granted in express words; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation—not simply convenient, but indispensable. Any fair, reasonable, substantial doubt concerning the existence of power is resolved by the courts against the corporation, and the power is denied." Quoted in Michelman, *supra* note 128, at 252-53.

139 ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, *supra* note 59, at 81.

140 194 Ore. 603 (1952).

141 356 Mo. 646, 203 S.W.2d 483 (1947).

142 352 Mo. 233, 176 S.W.2d 498 (1943).

143 356 Mo. 646, 203 S.W.2d 438, 443 (1947).

144 *Id.* at 444.

145 *Id.*

broad interpretation of local power would be unprecedented and against the presumption restricting local power—Dillon's Rule.[146]

Home rule powers of taxation have been liberally interpreted in only a minority of states, notably Ohio, California, and Michigan. The California constitutional provision in question empowers municipalities to make and enforce "all laws and regulations in respect to municipal affairs."[147] This clause was interpreted to include the power of taxation in *Franklin v. Peterson*.[148] Great use has been made of this power to enact local sales taxes, but as yet there are no local income taxes in California; San Francisco has considered the tax.[149]

The doctrinal context for the interpretation of the Ohio home rule power was set in *Zielonka v. Carrel*.[150] In 1912 as part of a constitutional amendment program heavily influenced by the Progressive movement, Ohio voters adopted Article XVIII, section 3:

> Municipalities shall have authority to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws.

In *Zielonka* the Ohio Supreme Court applied this section to uphold an occupational tax levied by Cincinnati. The court stated very realistically:

> There can be no doubt that the grant of authority to exercise all powers of local government includes the power of taxation, for without this power local government in cities could not exist for a day.[151]

However, in paragraph 2 of the Syllabus the court noted that this power was limited by the power of the General Assembly to interdict local taxation or occupy a particular tax field itself.[152]

What had been dictum in *Zielonka* grew into full-fledged doctrine over the next thirty years. In *Cincinnati v. AT & T*,[153] the court held that the General Assembly could occupy a tax field by pre-emptive implication,[154] that is, without uttering a word. The new doctrine was applied to invalidate a city excise tax in *Haefner v. City of Youngstown*.[155] In 1948 Glander and Dewey concluded from this development that in general the legislature could authorize local taxes in a field it had itself en-

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146 *Id.* at 445.

147 Cohn, *supra* note 127, at 42.

148 87 Cal. App. 2d 727, 197 P.2d 788 (1948).

149 TAX FOUNDATION STUDY, *supra* note 55, at 39.

150 99 Ohio St. 220, 124 N.E. 139 (1919). *See* Glander & Dewey, *Municipal Taxation: A Study of the Pre-Emption Doctrine*, 9 OHIO ST. L.J. 72, 75 (1948).

151 *Id.*

152 *Id.* at 76.

153 112 Ohio St. 493, 147 N.E. 806 (1925).

154 Glander, *supra* note 150 at 77.

155 147 Ohio St. 58, 68 N.E.2d 64 (1946). *See* Glander, *supra* note 150, at 75.

tered by passing interpretative legislation. But the legislature was seen by these authors as precluded from authorizing a local income tax; Article XII, section 8 of the Constitution (enacted at the same time as the home rule amendment, Article XVIII) authorized a state income tax with fifty per cent of the proceeds required to be returned to the locality of origin. Glander and Dewey felt (Glander has since changed his mind.) that this latter provision would be illogical if it were not the constitutional intent to pre-empt the income tax for state enactment.[156] (This is similar to the argument of the Colorado Supreme Court in *Denver v. Sweet, supra*, p. 42.) To this author, the argument seems unsound. First, there is Hartman's reply—an authorization to one is not a denial to the other,[157] but this reply is weaker here than in *Sweet* because of the fifty per cent sharing provision. Second, the argument seems to imply a premise about splitting revenue sources or types of taxes between states and localities, but there is no legal reason for this doctrine in any state except Virginia, where the constitution requires it. The only policy reason is to diversify the incidence of the tax system as a whole; this can be accomplished as well within any one level of government as among various levels.

The Ohio Supreme Court did not follow the Glander and Dewey argument. In *Angell v. City of Toledo*,[158] it held that the constitutional authorization did not pre-empt the field and that cities were free to levy an income tax, at least until the state did so itself. In so holding, it relied directly on the home rule amendment:

> A fundamental power of government is the power to raise revenue. At the time of the adoption of Article XVIII, there was adopted, and remains in effect, Section 13 thereof, which provides as follows: 'Laws may be passed to limit the power of municipalities to levy taxes and incur debts for local purposes. . . .'
>
> Section 6 of Article XIII of the Ohio Constitution [also] provides for the restriction of the power of taxation by municipalities.[159]

Under authority of the *Angell* case, Ohio cities have enacted income taxes without any specific authorization by statute.

When Cohn wrote in 1956, he assumed the validity of an Opinion of the Michigan Attorney General (Number 1409—1951) which denied Michigan municipalities the power to levy an income tax,[160] based on the Michigan version of Dillon's Rule. The Opinion went unchallenged until the 1962 enactment of the Detroit income tax. But Detroit's tax was upheld in *Dooley v. City of Detroit*.[161] The city relied upon a provision

156 *Id.* at 95. And *see* Glander, *The Uniform Municipal Income Tax Act*, 18 OHIO ST. L.J. 489 (1957).

157 Hartman, *supra* note 134.

158 153 Ohio St. 179, 91 N.E.2d 250 (1950).

159 153 Ohio St. 179, 182, 91 N.E.2d 250, 252 (1950).

160 Cohn, *supra* note 127, at 35.

161 370 Mich. 194, 121 N.W. 2d 724 (1963).

in the home-rule statute providing that "Each city may in its charter provide . . . (1) for laying and collecting rent, tolls and excises. . . ."[162] 51 American Jurisprudence 24 (Taxation) was cited for the notion that "excise" is a catch-all category, encompassing everything but poll and property taxes. The court broadened municipal autonomy in taxation:

> Consistent with the whole purpose of the home rule cities act and the constitutional provisions pursuant to which it was enacted, the authority granted was in broad general terms, each city being left free to determine for itself what excises would best meet its local needs.[163]

Carter Carburetor and *Denver v. Sweet* were distinguished on the grounds that the grants of home rule power in those cases limited taxing powers to those granted specifically by the legislature.[164] *Angell v. Toledo, supra,* was recognized as a parallel case.[165]

Cohn concludes that constitutional home rule as a political program has failed to help solve the revenue problems of the cities because judges have not been given clear enough standards upon which to interpret the provisions.[166] It seems to this author that the standards set out in *Angell, supra,* are the proper ones. First, cities should not be barred from choosing a superior fiscal instrument like the income tax; its fiscal virtues have been outlined above. But second, because the tax is imposed upon nonresidents who have no vote in municipal elections, it is important that the state legislature retain ultimate reviewing power over its operation.

B. *Conditions Upon Use*

State authorizations to cities, express or implied to use the income tax are limited by additional doctrines and additional state policies. The most important of these are described below.

1. *The Uniformity Requirement*

Most state constitutions contain a clause requiring that taxation be uniform within the classes of subjects to which it is applied. The clauses have been applied to hold a number of state graduated income taxes invalid, for example, in Massachusetts, Illinois, Pennsylvania, Washington, and New Hampshire.[167] An equal number of states have held the other way, including Missouri, Georgia, Indiana, Arkansas, Kentucky, Minnesota, and Mississippi.[168] The original Philadelphia city income tax was

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162 370 Mich. 194, 121 N.W.2d 724, 727 (1963).
163 *Id.* at 732.
164 *Id.* at 733.
165 *Id.*
166 Cohn, *supra* note 127, at 31.
167 J. Hellerstein, STATE AND LOCAL TAXATION 44-6 (3rd ed. 1969).
168 *Id.*

held to violate the Pennsylvania uniformity requirement in *Butcher v. City of Philadelphia*.[169] The cases are not examined in detail here because of length. But it is this author's conclusion that the uniformity clauses are not properly applied to invalidate graduated rates. These clauses were primarily intended to prevent inequities in assessments of real property, and they have been used successfully to attack grossly disparate assessment/market value ratios. Income taxes are not property taxes—no assessment is required. While an ethical case has often been made for progressive income taxation,[170] no such case has been made for the types of inequities which grow up in assessments and which are not related at all to the income of the owners. Of course, if courts persist in this doctrine, cities will not be badly hurt: few levy graduated taxes, and those that do are primarily motivated by equity rather than revenue considerations. Use of graduated rates as applied to nonresidents raises no federal questions.[171]

2. *Credits and Rate Limitations*

Cities and state legislatures have dealt with the possible inequities inherent in taxing the commuter to support two local governments by granting credits against one city's tax for payments to the other. These credit arrangements exist in several different patterns.

In Ohio credits are not required to be given by state law. See *Thompson v. City of Cincinnati*;[172] the Ohio Supreme Court refused to impose the requirement because the Ohio General Assembly had refused to enact a compulsory credit or deduction system when it enacted the so-called Uniform Municipal Income Tax, Ohio Revised Code, Chapter 718.[173] In consequence, Ohio city credits usually favor the city of employment: central cities give credits to residents for taxes paid to outlying jurisdictions where they work if the outlying jurisdictions grant the same credit reciprocally.

In addition, Ohio Revised Code 718.01 requires that the rate of taxation be uniform at one per cent unless there is approval of a different rate by 55 per cent of the electorate at a general election or 60 per cent at a special election.

Pennsylvania in its 1948 general enabling act gave priority to the city of residence. That is, cities of employment are required to give a credit for taxes paid to cities of residence.[174] Philadelphia is the exception: cities of residence cannot tax income earned in Philadelphia. In addi-

[169] 333 Pa. 497, 6 A.2d 298 (1939).

[170] *See*, e.g., W. Blum & H. Kalven, Jr., THE UNEASY CASE FOR PROGRESSIVE TAXATION (1953).

[171] Wheeler v. Vermont, 127 Vt. 361, 249 A.2d 887 (1969), *cert. den.* 396 U.S. 4 (1969).

[172] 2 Ohio St. 2d 292, 208 N.E.2d 747 (1965).

[173] Hellerstein, *supra* note 167, at 613.

[174] PA. ANN. STAT. tit. 52, § 6855.

tion, no Pennsylvania school district may tax the income of nonresidents, apparently on the theory that nonresidents get no benefits from the schools. The priority of residence led a hundred small suburbs of Pittsburgh to enact the tax in "retaliation" for the Pittsburgh tax.[175]

Michigan has gone somewhat further than either Pennsylvania or Ohio in broadening the base of its cities' income taxes. In its uniform act a one per cent rate for residents and a one-half per cent rate for nonresidents is provided. The city of residence is then required to give a credit for taxes paid to the city of employment, so that in effect the tax is split half and half by the two jurisdictions as long as they both levy it. Detroit is permitted to tax at the rate of two per cent.[176]

One basic problem with all of the credit schemes is that they work only among taxes of the same type. Thus the central city may give a credit on nonresidents' tax for residential income tax, but no such city gives a credit for residential property taxes. Consequently the system discriminates between two commuters carrying equal residential tax burdens, depending upon the type of tax used. This creates an incentive for suburbs to enact income taxes. But because of economies of scale in administration, the tax is rarely a very good revenue instrument for the small suburb.

It is suggested that if the state's goal is additional revenue for its large cities that it permit only the large cities to levy the tax at all. This is the situation in Missouri, where only St. Louis and Kansas City have authority to tax incomes. If it is thought that this system overburdens some commuters, they can be given relief by way of state income tax deductions (where state income taxes exist) instead of encouraging multiple retaliatory enactments of the tax.

VI. *Summary and Conclusion*

The municipal income tax is almost certainly here to stay. If the Ohio experience is any indication, it may increasingly replace the property tax as the mainstay of large-city government. We have seen its fiscal advantages and the justifications for using it to tax commuters. We have examined federal and state limitations on its use. The conclusion from the study of doctrine is that a great deal of responsibility lies with state legislatures for future development of the tax. Cities have originated the concept and made it work, but only state legislatures contain representatives of all the people being taxed. Courts have set the outer limits of the tax, but lack the tools to make fine adjustments in balancing the interests of residents and nonresidents.

*Michael R. Merz**

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[175] Sigafoos, *supra* note 55, at 29.

[176] TAX FOUNDATION INC., *supra* note 55.

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